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Sensitive but Unclassified. Protect accordingly.

[11](#). (SBU) Summary: On March 10 Canada's federal government provided significant additional detail on its "Turning the Corner" climate change plan released last year. This latest iteration announced the government's intent to establish a clear price signal for carbon and greater detail on plans to establish a domestic trading scheme for GHG emissions. Draft regulations will be developed and put out for public comment in fall 2008. Final regulations should be approved by the fall of 2009 and come into force on January 1, 2010. The federal plan does not mesh evenly with current provincial climate change approaches, likely leaving gaps and varying standards in place across the country. End Summary.

[12](#). (U) On March 10 the federal government unveiled further details of its regulatory framework for greenhouse gas (GHG) emissions. The framework, originally announced in April 2007 (Ref B), is intended to reduce GHGs by 20 per cent below 2006 levels by 2020 and cut emissions by 60-70 per cent by 2050, initially via emissions-intensity reduction targets and after 2025 through fixed emissions caps. If these targets are met, Canada would produce in 2020 about 610 megatons (Mt) of carbon dioxide (CO2) equivalent GHGs, 330 megatons less than under a business as usual scenario. The final regulations are intended to apply to about 700 facilities in 16 key industrial sectors, including power generation, oil and gas, pulp and paper, iron and steel, smelting, and refining. Some industrial facilities with emissions under 50 kilo-tons (kt) per year of CO2 equivalent will be exempt, as will "fixed process" facilities, whose emissions are not combustion related. According to government calculations, the plan will have a measurable negative economic impact, which is not estimated to exceed 0.5 percent of Canada's projected real GDP in any single year between 2010 and 2020.

[13](#). (U) The federal government calculates that federal measures alone will reduce GHG emissions in 2020 by approximately 230 megatons (with 165 megatons of this reduction attributable to measures in "Turning the Corner"). Independently, provincial and territorial governments have already committed to targets implying a further reduction of around 300 megatons. There is overlap with federal efforts, but the government believes provincial and territorial initiatives already underway will supply incremental

reductions of 40 megatons, and expects provinces and territories to introduce additional measures yield incremental reductions of another 35 megatons. With an added 25 megatons from the efforts of a federal-provincial-industry clean electricity task force, the federal government believes the targeted reductions of 330 megatons (20 percent) from 2006 levels are within reach.

New Details

14. (U) The additional detail announced on March 10 elaborated on the emissions reduction targets released almost a year ago. All covered industrial sectors (see full list in para 17) will be required to reduce their emissions intensity from 2006 levels by 18 percent by 2010, with 2 percent continuous improvement every year after that. These intensity targets will be applied at the facility, sector or corporate level as determined after consultation with the affected industries, and minimum thresholds for application will be set in five sectors. For chemicals, nitrogen-based fertilizers, and natural gas pipelines the threshold will be 50 kt CO2 equivalent per year. The threshold for the electricity sector will be 10 MW generating capacity. For upstream oil and gas, the targets will apply to facilities with 3 kt of emissions per year and 10,000 barrels of oil per day. Although the federal thresholds for upstream oil and gas are more stringent than those announced by the province of Alberta in its 2007 "Specified Gas Emitters Regulations," the federal government says it is committed to a "common threshold and reporting regime in Alberta."

15. (U) As announced in April 2007, "Fixed Process" emissions will receive an exemption (technically an intensity reduction target of 0 percent), but the March 10 announcement provides a more precise definition of fixed process emissions.

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Greenhouse gas emissions from a "fixed process" are a direct result of the production process, not a result of combustion or from the processing of crude oil or natural gas. Fixed processes account for about 60 percent of GHG emissions from the iron and steel sector and the cement sector, 50 percent from the aluminum sector, 40 percent from the fertilizer sector, and smaller shares in other sectors. The non-fixed process portion of GHG emissions in all regulated industrial sectors will be subject required emission reductions.

16. (U) The most significant modification in the March 10 update is that all oil sands up-graders and in-situ plants and all coal-fired electricity plants that come into operation in 2012 or after will be required to meet stricter emissions targets (using carbon capture and storage or its equal in effectiveness) or pay C\$15 per ton of CO2 equivalent GHGs emitted over their limit. (The effective "price" of a ton of excess CO2 equivalent GHG emissions is expected to grow to about C\$65 per ton by 2018-20). In order to ensure that carbon capture and storage (CCS) is "widespread by 2018," the plan envisions that firms will be credited for investments in "pre-certified CCS projects" for up to 100 percent of their regulatory obligation through 2017. (Comment: The devil is in the details, as Canadian Association of Petroleum Producers president Pierre Alvarez pointed out. "We'll have to figure out what it means" since the plan remains "thin on detail" with no specifics on which carbon capture and storage projects might qualify. End comment).

17. (U) This CCS approach does mesh well with the call in January 2008 by the joint Canada-Alberta Carbon Capture and Storage Task Force for the immediate creation of a C\$2 billion government fund to kick-start development of carbon capture and storage projects in Canada. So far, Alberta has committed "up to" C\$500 million, while the federal budget of February 2008 pledged C\$250 million. However, almost all of this federal money is for a zero-emissions coal-fired power

plant in Saskatchewan.

¶8. (U) The March 10 release also provided additional information on the availability of Clean Development Mechanism (CDM) and domestic offsets. Firms may use credits from the Kyoto Protocol's CDM for up to 10 percent of their regulatory obligation. The domestic offset system will be administered by Environment Canada. Domestic offset projects must take place in Canada and achieve reductions in one or more of carbon dioxide, methane, nitrous oxide, hydrofluorocarbons (HFCs), perfluorocarbons (PFCs), or sulfur hexafluoride. Each offset credit will represent one ton of carbon dioxide equivalent. The plan notes that consideration will be given to recognizing reductions originating in the U.S., "once the United States has a regulatory system in place," and goes on to state that a good example of emissions that could be covered by such an arrangement are those stored by the Weyburn-Midale CCS project. The government expects to publish detailed guidance for project proponents and verification bodies this spring and summer, and Environment Canada will begin reviewing project applications in the autumn.

¶9. (U) The announcement further defined "Credits for Early Action." Firms that took verified early action to reduce emissions between 1992 and 2006 will be eligible for a total of 15 Mt in credits (5 Mt per year in 2010, 2011 and 2012). These credits will be bankable and tradable. The government is seeking feedback until May 18, 2008, on the proposed eligibility and allocation rules for the credits.

Establishing a Carbon Price Signal

¶10. (U) In early January 2008, in response to a government request for advice on reducing GHG emissions over the longer term, Canada's arms-length advisory body, the National Roundtable on the Environment and Economy (NRTEE), recommended the federal government "implement a strong, clear, consistent and certain GHG emission price signal across the entire Canadian economy as soon as possible in order to successfully shift Canada to a lower GHG emissions pathway" and institute an "emission tax or a cap-and-trade system or a combination of the two." This newest iteration of the "Turning the Corner" plan emphasizes the government's intent to take up the NRTEE recommendation and establish "a market price for carbon."

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¶11. (U) Under the Regulatory Framework, firms are offered several different options to meet their emissions intensity targets: they may undertake in-house abatement, or they may contribute to the new government-managed "Technology Fund," acquire emission credits from other domestic regulated industries, purchase offset credits from domestic sources outside of regulated sectors, or use CDM. In the government's economic modeling, the lowest cost option, the Technology Fund's contribution rate of C\$15 per ton CO₂ equivalent in 2010-12, has the effect of moderating the price in the early years of the regime; the cost of contributions to the Technology Fund then rises to C\$20 per ton in 2013 and beyond, but at the same time the maximum allowable Fund contributions decline from 70 percent of a firm's regulatory obligation in 2010 to zero by 2018. Receipts into the Fund will be invested in qualifying GHG emissions reductions technology projects.

¶12. (U) This structure, coupled with the required emissions intensity improvements rate of 2 per cent per year after 2010, means the carbon price signaled by the overall framework to industry increases steadily. As a result, by about 2015, the Fund is beginning to play a marginal role in setting that price signal for industrial reductions, and it is instead the market price of emissions (i.e., what it costs firms to achieve actual reductions) that drives the selection

of compliance options in the model. By 2018, firms will be responding to carbon (CO2 equivalent) prices expected to be in the range of C\$65 per ton. The government anticipates that at this price in-house reductions and purchase of offsets from outside the regulated sectors will be cost-competitive options. (Note: Although the government has yet to fully address how it will enforce compliance, we note the Minister of the Environment has certain administrative authorities granted by the Canadian Environmental Protection Act (1999) that may be applied. End note.)

Market Balkanization?

¶13. (SBU) Through the domestic offsets mechanism noted earlier, the plan "takes the first step to set up a carbon emissions trading market," the second key NRTEE recommendation. However, as the federal government moves forward with plans to create a trading system for greenhouse gas emissions, significant hurdles remain. For example, the federal plan anticipates a market for emissions credits across Canada, irrespective of provincial boundaries, but Alberta insists companies in Alberta can only purchase offsets to meet their emissions targets from suppliers in that province. As Alberta Premier Stelmach noted, "We're not...looking at an interregional transfer of wealth." Meanwhile Manitoba and British Columbia are collaborating in developing a regional emissions markets with a number of American states in the Western Climate Initiative. Quebec and Ontario are observers in, and eventually want to join, the Regional Greenhouse Gas Initiative (RGGI) of northeastern and mid-Atlantic states. "Turning the Corner" notes that Canada would consider recognizing reductions originating in the United States if the U.S. establishes a comparable regulatory system.

Just Another Step in a Long Process

¶14. (U) This version of the regulatory framework is but another step in this government's iterative process to develop a workable climate change policy that began in October 2006 with Bill C-30 and the affiliated "Notice of Intent in Regulate" (Ref C), followed by the unveiling of the original Turning the Corner plan in April 2007 (Ref B). The government has also announced a grab bag of federal grants and policy initiatives across the climate change spectrum (Ref A). We understand, however, that this edition of the framework is the final post-consultation version with validated targets and measures, and will be translated into regulatory language. Draft regulations are expected to be published in the Canada Gazette, Part I, for public comment in the fall of 2008. The final regulations are expected to be approved and published in the Canada Gazette, Part II, in the fall of 2009 and come into force on January 1, 2010.

¶15. (U) The April 2007 Turning the Corner plan covered other air pollutants (SOx, NOx, and volatile organic compounds) as well as greenhouse gases. The government anticipates adding

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the air pollutant regulatory elements to the draft regulations for publication in the Canada Gazette, Part I, this fall.

Comment

¶16. (SBU) Effective climate policy in Canada still faces a number of conceptual and practical hurdles, and the prospect of federal -- and provincial -- regulation introducing serious unintended consequences is very real. The keystone of the government's plan is a technology solution (carbon capture and storage) whose effectiveness on a large scale has not yet been demonstrated. Key CCS parameters are ill-defined, including the list of "pre-certified CCS" projects that can be used to offset emissions. And the development of a GHG emissions trading market is proceeding

piece meal across the country. Coherent solutions to these challenges will have to be addressed in the next step in the process, the draft regulations to be published in the autumn of 2008, for this plan to continue turning the corner on climate change. End Comment.

¶17. (U) The regulatory framework for industrial greenhouse gas emissions will apply to the following sectors: 1) oil sands, 2) electricity, 3) petroleum refining, 4) chemicals, 5) fertilizers, 6) upstream oil and gas, 7) natural gas pipelines, 8) potash, 9) iron ore pelletizing, 10) lime, 11) iron and steel, 12) titanium, 13) pulp and paper, 14) aluminum and alumina, 15) cement, and 16) base metal smelting.

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